

INFORMATION

Income Taxes

Deductibility of Entertainment Expenses

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FROM announcements and rulings in recent weeks, it appears that your next income tax return is going to get the closest scrutiny ever by the Internal Revenue Service. Entertainment expenses will get a particularly close checkup in line with the established policy of the tax authorities to scrutinize expense accounts in auditing income tax returns for abuses in claims for deductions for entertainment and other business expenses. In a recent special ruling, the Internal Revenue Service laid down a set of criteria for the deduction of entertainment expenses by physicians which will be useful to guide physicians who are planning to take deductions for business entertainment.

Generally speaking (and quite apart from the special ruling applicable to physicians) entertainment expenses are deductible if they are ordinary and necessary expenses incurred in the operation of a business regularly carried on by the taxpayer. To be deductible as business expenses, entertainment expenses must have a proximate relation to the taxpayer's trade or business and be of a character reasonably expected to benefit that trade or business. A physician thus may deduct on his income tax return the costs of entertainment, provided he can establish to the satisfaction of the Internal Revenue Service that such expenses are ordinary and necessary business expenses and clearly related to the production of business income.

The previously mentioned special ruling* specifically discusses the problem of deductibility of entertainment expenses by physicians and sets out a check list for determination of deductibility. According to its provisions the deduction for costs of entertainment may be claimed when the physician is able to show that the entertainment had a direct relationship to the conduct of his practice, and can show the business benefit reasonably to be expected from the expenditure. The general statement that he hoped or expected to get referrals or patients as a result of the entertainment is not enough, and if personal reasons predominate, the expenditure may not be deducted, even though there is some possibility of a business benefit.

*Special Ruling, CCH, Sec. 6575.

The ruling distinguishes between the entertainment of other physicians and the entertainment of persons who are not physicians, stating: "Except in the case of industrial physicians, entertainment of individuals who are not doctors will not ordinarily qualify because the possibility of benefits to be expected are so remote as to be negligible." Thus, except for an industrial physician, whose clientele differs considerably from that of the specialist or the physician in general practice, the deduction for entertainment expenses would seem to be limited to amounts spent in entertaining other physicians who might refer patients. Nevertheless, in instances of the entertainment of patients, it is clear that the same general rules apply as in the entertainment of other physicians and the clear relationship of the expenditure to reasonably expected income must be shown.

Criteria to be used in establishing the deductibility of entertainment expenses, according to the ruling, include the following:

- "a. Specific purpose of the entertainment.
- "b. Nature of the practice of the doctor incurring the expenditure.
- "c. Period of time the doctor has been in practice and the number of patients he already has.
- "d. Percentage of his patients received as referrals.
- "e. Names of individuals entertained and reason why additional income could reasonably be expected from each.
- "f. Whether or not referrals were actually received from the doctors entertained and any indication of the effect of the entertainment on these referrals.
- "g. Number of times individual doctors were entertained during the year, inasmuch as repeated entertainment indicates a personal motive.
- "h. Whether or not other doctors in the same type practice in the locality have entertainment expenses."

Although the policy of the Internal Revenue Service on deductibility of entertainment expenses is a strict one, there is no reason why members of the medical profession are not to be allowed deductions for business entertainment, just as other professionals are, so long as there is a direct relationship between the expense and the development or expansion of a medical practice. But it must be kept in mind that the mere hope of referred patients is not enough to justify a deduction—there must be a definite possibility, or reasonable expectation, that medical fees will result from the entertaining.

Assuming an entertainment expense is deductible, the amount of the deduction must be carefully considered. Under the current tax law, it seems that

amounts spent by an individual in entertaining customers or clients will rarely be deductible in full because a portion of the expense is usually attributable to the taxpayer or his family. The Tax Court unanimously held that only the portion of the entertainment outlay which is shown to be different from or in excess of the amount you would ordinarily spend on yourself or your family is deductible.[†] For example, let us assume you entertain another physician for lunch, and the tab is \$10.00, or about \$5.00 for each of you. Assuming a deduction can be claimed, how much can you deduct? This will depend upon what you ordinarily spend for your own lunch. Assuming that you ordinarily spend about \$2.00 for lunch, you would probably be entitled to deduct up to \$8.00 under the tax rules. Thus, the taxpayer must not only show that the entertainment expenditure is deductible as a business ex-

pense, but must show how much of his share of the expenditure exceeds any nondeductible personal expenditure.

To complete the entertainment expense picture, it must be noted that the importance of keeping appropriate records of business expenses cannot be overemphasized. In many cases, deductions for entertainment expenses have been disallowed because the taxpayer could not sustain his claim by more than a loose estimate. Whenever a revenue agent questions whether or not an expense claimed as a deduction was actually incurred, the burden of proof is on the taxpayer. The Internal Revenue Service is not required to prove that the taxpayer did not incur the claimed expense. The taxpayer must therefore not only use caution in claiming deductions for entertainment expenses, but must insure that any deduction taken can be justified by adequate records.

[†]Richard A. Sutter, 21 T.C. 170; J. W. Scott, 15 T.C.M. 1431.

Blue Shield Medical Care Coverage for the Aged

THE NATIONWIDE Blue Shield Plans and their sponsoring medical societies have registered outstanding progress in implementing the American Medical Association resolution—passed a year ago calling for the development of medical care coverage for the aged by voluntary means, John W. Castellucci, executive vice-president of the National Association of Blue Shield Plans said in Chicago recently.

"We have just completed a special survey in order to determine the progress made by Blue Shield Plans since the passage of the A.M.A. resolution in December 1958, and the results are most encouraging," Mr. Castellucci reported.

"Only eight of the 67 Blue Shield plans located in the United States, with only two per cent of total Blue Shield membership, have no programs for senior citizens in the works at the present time," he noted.

Mr. Castellucci said that the remaining 59 plans either have special aged programs already being offered in their areas, or have programs in various stages of development.

Specifically, the study conducted by the national Blue Shield association showed that 32 of the plans, representing more than 50 per cent of total enrollment, have made available nongroup programs for persons over the age of 65. Three plans, with about 15 per cent of total Blue Shield membership, have programs already approved and ready to be offered as soon as the mechanics of administration are completed. Also, 23 additional plans, covering 30 per cent of total enrollment, have senior citizen programs in various stages of development and these

plans report that they expect their programs to be in force early in 1960.

Thus, about 98 per cent of the total United States Blue Shield enrollment is in areas where special aged programs are already being offered or are in stages of development, all within a year after passage of the A.M.A. resolution.

Mr. Castellucci indicated that in the development of programs for senior citizens, the plans have followed three general lines of approach: (1) Developed new programs designed specifically for persons over 65; (2) effected modifications in existing programs to accommodate enrollees over 65; (3) eliminated age limits on existing nongroup programs offered to the general public who are not eligible to join through their place of employment.

Before the passage of the A.M.A. resolution, the national Blue Shield organization noted, only a limited number of plans had special programs for the aged, although all plans traditionally imposed no age limit on group enrollment and permitted continuation of Blue Shield coverage to all members who had acquired it prior to reaching 65.

"While it is realized that the many and varied problems confronting our senior citizens cannot readily be solved in a short period of time, it is heartwarming to note the significant progress made by Blue Shield plans throughout the country in the past year in developing programs to meet the special medical needs of persons over 65. In offering these programs, Blue Shield, of course, is fully cognizant of the splendid cooperation offered by sponsoring medical societies without whose efforts such significant progress could not have possibly been recorded in 12 short months," Mr. Castellucci said.